



AN INTRODUCTION TO CROWDFUNDING

By Jason Powell, Esq.

Foster
Garvey



WHAT IS CROWDFUNDING?

Crowdfunding is the biggest buzzword in raising capital since the Jumpstart Our Business Startups Act of 2012 (JOBS Act) was enacted. The word crowdfunding is synonymous with advertising for investors, which under the JOBS Act is allowed. Crowdfunding was permitted prior to the enactment of the JOBS Act but only for not-for-profit ventures; for-profit companies could not advertise for investors unless they had an approved intrastate offering. In the simplest sense, crowdfunding is a method of raising capital from a large number investors, typically via the internet.

Crowdfunding falls into one of three categories: Regulation D, Rule 506(c), Regulation A+ and Regulation CF.

REGULATION D, RULE 506(C)

Regulation D allows companies to raise capital through the sale of equity or debt securities. Regulation D provides an exemption to sell securities in a private capital raise, without registering the securities with the SEC. Regulation D also provides the appropriate documentation for accepting and using capital.

Traditionally, there was only one type of Rule 506 offering, which prohibited general solicitation and public advertising. Following the JOBS Act, the traditional Rule 506 exemption became known as Rule 506(b) and a new exemption, known as Rule 506(c) became effective. Rule 506(c) allows private issuers to generally solicit, or advertise, their offering, but actual investments must be from accredited investors only.

There are 3 important distinctions between Regulation D, Rule 506(b) and Regulation D, Rule 506(c).

INFORMATION

If all the investors are accredited, there is no difference between Rule 506(b) and Rule 506(c). If there is even one non-accredited investor in a Rule 506(b), offering the issuer must provide much more information.

ADVERTISING

In a Rule 506(b) offering, you can advertise only the issuer's brand; however, in a Rule 506(c) offering, you can advertise the deal. An issuer undertaking a 506(b) offering can use their website to attract investors, who sign up and go through a know-your-customer process following Securities and Exchange Commission (SEC) guidelines. This involves the investor completing questionnaires, speaking with the investor on the phone, learning about the investor's experience and knowledge investing – in essence, the issuer is developing a relationship with the investor. Then, and only then, can the issuer show the investor actual investments.

In contrast, an issuer can show actual investments on its website, under Rule 506(c), to anyone who visits the website.

ACCREDITED INVESTOR VERIFICATION

In a Rule 506(b) offering, the issuer may take the investor's word that the investor is accredited, unless the issuer has reason to believe the investor is lying. In a Rule 506(c) offering, the issuer must take reasonable steps to verify that every investor is accredited. The SEC's regulations allow an issuer to rely on primary documents from an investor like tax returns, brokerage statements or W-2s, but they also allow the issuer to rely on a letter from the investor's lawyer, accountant or broker. I do not recommend to my clients that they handle the verification process but, rather, that they obtain a certification letter from the

investor's lawyer, accountant or broker. Alternatively, issuers can use a third-party service such as [verifyinvestor.com](https://www.verifyinvestor.com).

REGULATION A+

Regulation A+ was created by the JOBS Act in 2012. Regulation A+ encourages small business growth and development by streamlining the process for going public and easing limitations on the number of non-accredited shareholders an eligible company can have. Like an initial public offering (IPO), Regulation A+ allows companies to offer securities to the general public and not just accredited investors. Companies looking to raise capital via Regulation A+ first need to file with the SEC and get approval before raising capital. However, the fees associated with a Regulation A+ offering are much lower than a traditional IPO, and the ongoing disclosure requirements are much less burdensome, effectively making a Regulation A+ offering a mini-IPO.

Regulation A+ has 2 tiers:

1. **Under Tier 1**, a company can raise up to \$20 million in any 12-month period. For Tier 1 offerings, the offering circular must be filed with, and is generally subject to review and qualification by, the SEC. The offering circular must also be distributed and reviewed by the securities regulator in the states where the offering is being conducted. Tier 1 financial statements do not have to be audited.
2. **Under Tier 2**, a company can offer up to \$75 million in any 12-month period. For Tier 2 offerings, the offering circular is subject to review and qualification by the SEC but is not subject to review by state securities regulators. Tier 2 financial statements must be audited by an independent accountant.

REGULATION CF

Regulation Crowdfunding (or Regulation CF), also known as equity crowdfunding, was adopted under Title III of the JOBS Act in 2016. Under Regulation CF, US companies may raise up to \$5 million in any 12-month period from both accredited and non-accredited investors, and general solicitation of the offering is permitted with some limitations.

In a Regulation CF offering there are no investment limits placed on accredited investors. Non-accredited investors are subject to investment limits based on the greater of annual income and net worth.

All Regulation CF offerings must occur entirely through a single SEC/FINRA registered broker-dealer or online funding-portal.

ABOUT THE AUTHOR

As a results-oriented dealmaker, Jason enjoys creating solutions that bring together great people, projects and capital.

When working on sophisticated business and financing transactions, Jason focuses on the big picture to ascertain his clients' strategic business direction and formulate risk mitigation strategies to protect corporate capital and profitability. His extensive experience includes advising businesses, lenders, investors, startups, and real estate investment companies and developers across the United States, on business transactions from formation to exit, acquisition, due diligence, real estate securities offerings, joint ventures, disposition and financing of real estate.

Passionate about real estate investing, Jason frequently speaks, writes and teaches on the topic, and is also a real estate investor himself. He has authored two books about private money lenders and is working on an eBook focusing on real estate syndication. Jason leads Foster Garvey's Real Estate Funds & Syndications Team.

CONTACT

jason.powell@foster.com | 503.553.3185

Foster Garvey

SEATTLE

1111 Third Avenue
Suite 3000
Seattle, WA 98101

T: 206.447.4400
F: 206.447.9700

PORTLAND

Bank of America
Financial Center
121 SW Morrison Street
11th Floor
Portland, OR 97204

T: 503.228.3939
F: 503.226.0259

WASHINGTON, D.C.

Flour Mill Building
1000 Potomac Street
N.W., Suite 200
Washington, D.C. 20007

T: 202.965.7880
F: 202.965.1729

NEW YORK

100 Wall Street
20th Floor
New York, NY 10005

T: 212.431.8700
F: 212.334.1278

SPOKANE

618 West Riverside
Avenue, Suite 300
Spokane, WA 99201

T: 509.777.1600
F: 509.777.1616

BEIJING

821 South Tower Beijing
Kerry Center 1 Guang
Hua Road Chaoyang
District Beijing, PRC
100020

T: 86.10.8529.9880
F: 86.10.8529.9881